

APAC CUSTOMER SERVICES, INC

Form 10-Q

May 12, 2011

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the quarterly period ended April 3, 2011

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the Transition Period From _____ to _____

Commission file number: 0-26786

APAC Customer Services, Inc.

(Exact name of registrant as specified in its charter)

Illinois

(State or other jurisdiction of incorporation or organization)

36-2777140

(I.R.S. Employer Identification No.)

Bannockburn Lake Office, 2201 Waukegan Road, Suite 300, Bannockburn, Illinois 60015

(Address of Principal Executive Offices, Zip Code)

Registrant's telephone number, including area code: **(847) 374-4980**

Indicate by check mark whether registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (see the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act).

Large accelerated filer Accelerated filer Non-accelerated filer* Smaller reporting company

(*Do not check if a smaller reporting company)

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

There were 51,218,419 common shares, \$0.01 par value per share, outstanding as of May 6, 2011.

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Forward-Looking Statements and Factors That May Affect Future Results

In passing the Private Securities Litigation Reform Act of 1995 (the Reform Act), Congress encouraged public companies to make forward-looking statements by creating a safe harbor to protect companies from securities law liability in connection with forward-looking statements. We intend to qualify our written and oral forward-looking statements for protection under the Reform Act and any other similar safe harbor provisions. Unless the context indicates otherwise, the words Company, we, our, and us when used in this Quarterly Report on Form 10-Q refer collectively to APAC Customer Services, Inc. and its wholly-owned subsidiaries.

Generally, forward-looking statements include expressed expectations, estimates and projections of future events and financial performance and the assumptions on which these expressed expectations, estimates and projections are based. Statements that are not historical facts, including statements about our beliefs and expectations and those of our management, are forward-looking statements. Sometimes these statements will contain words such as believes, expects, anticipates, intends, estimates, goals, would, could, should, plans, and other similar terms. Forward-looking statements are inherently uncertain as they are based on various expectations and assumptions about future events, and they are subject to known and unknown risks and uncertainties that can cause actual events and results to differ materially from historic results and those projected.

Due to such uncertainties, the investment community is cautioned not to place undue reliance on our written or oral forward-looking statements, which speak only as of the date on which they were made. If no date is provided, such statements speak only as of the date of this Quarterly Report on Form 10-Q. We expressly undertake no obligation to publicly update or revise any forward-looking statements as a result of changed assumptions, new information, future events or otherwise.

Forward-looking statements are contained in this Quarterly Report on Form 10-Q, primarily in Items 2 and 3. Moreover, through our senior management, we may from time to time make forward-looking statements about matters described herein or about other matters concerning us.

There are numerous factors that could prevent us from achieving our goals and cause future results to differ materially from historic results or those expressed or implied by forward-looking statements including, but not limited to, the following:

A large portion of our revenue is generated from a limited number of clients and the loss of one or more of them, or a reduction in their demand for our services, could materially and adversely affect our financial results.

Our operating results and financial condition may be affected by the performance of our clients and unfavorable general economic conditions.

The failure to effectively manage our production capacity and our workforce could negatively impact our financial results.

Our success is subject to the terms of our client contracts and if we are unable to continue operating under existing client contracts or renew existing client contracts with terms favorable to us, our results of operations and financial condition may be adversely affected by the loss of clients or by the less favorable terms.

Our business may be affected by our cash flows from operations and our ability to comply with our debt covenants and funding requirements under our credit facility.

Our financial results may be affected by risks associated with international operations and expansion, including, but not limited to foreign currency fluctuations, tax obligations and changes to laws in other countries.

Our principal shareholder can exercise significant control over us and, as a result of such control may be able to exert considerable influence over our future direction and operations.

Our success depends on our ability to recruit and retain a sufficient number of qualified key personnel and the loss of the services of key personnel without adequate replacement or the inability to attract new qualified personnel could have a material adverse effect on us.

We operate in a highly competitive industry and our financial results may suffer if we are unable to adequately address potential downward pricing pressures and other competitive factors.

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Circumstances outside our control such as typhoons, hurricanes, earthquakes, floods and other acts of God, political instability, equipment malfunction, telephone or data service interruptions, changes in the telecommunications market, war and terrorism could seriously harm our domestic or international business operations.

Unauthorized disclosure of sensitive or confidential client and customer data could expose us to protracted and costly litigation, penalties and may cause us to lose clients.

Our business and our clients' businesses are subject to federal and state regulation and industry standards and the costs of compliance with, or liability for violation of, existing or future regulations or standards could significantly increase our costs of doing business.

The costs and management time and attention associated with litigation could result in a negative impact to our financial results.

Our business is subject to rapid changes in technology and if our technology is rendered obsolete or we are unable to compete effectively, our operating results and financial condition could be materially and adversely affected.

Volatility in our stock price may result in loss of investment for shareholders, potential litigation and substantial cost associated with litigation, as well as diversion of management's attention.

See our filings with the Securities and Exchange Commission (SEC) for further discussion of the risks and uncertainties associated with our business, in particular, the discussion in Item 1A of Part I of our Annual Report on Form 10-K for the fiscal year ended January 2, 2011, and in Item 1A of Part II of this Quarterly Report on Form 10-Q. In various places throughout this Quarterly Report on Form 10-Q we use certain non-GAAP financial measures when describing our performance. A non-GAAP financial measure is defined as a numerical measure of a company's financial performance that excludes or includes amounts so as to be different than the most directly comparable measure calculated and presented in accordance with GAAP in the statements of operations, balance sheets or statements of cash flows of a company. We believe that non-GAAP financial measures provide meaningful supplemental information and are useful in understanding our results of operations and analyzing of trends because they exclude certain charges such as interest, taxes and depreciation and amortization expenses that are not part of our ordinary business operations. We also believe that non-GAAP financial measures are useful to investors and analysts in allowing for greater transparency with respect to the supplemental information used by us in our financial and operational decision-making. In addition, we believe investors, analysts and lenders benefit from referring to non-GAAP measures when assessing our performance and expectations of our future performance. However, this information should not be used as a substitute for our GAAP financial information; rather it should be used in conjunction with financial statement information contained in our unaudited condensed consolidated financial statements prepared in accordance with GAAP. We discuss non-GAAP financial measures in Item 2 of this Quarterly Report on Form 10-Q under the caption Management's Discussion and Analysis of Financial Condition and Results of Operations Non-GAAP Financial Measures. Pursuant to the requirements of Regulation G, we have provided a reconciliation of all non-GAAP financial measures to the most directly comparable GAAP financial measure in Item 2 of this Quarterly Report on Form 10-Q.

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APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

| | April 3, 2011 (Unaudited) | January 2, 2011 |
|---|--|----------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 51,268 | \$ 41,399 |
| Accounts receivable, net | 46,772 | 52,483 |
| Deferred tax assets, current | 7,606 | 11,051 |
| Other current assets | 8,288 | 8,204 |
| Total current assets | 113,934 | 113,137 |
| Property and equipment, net | 28,065 | 28,030 |
| Goodwill and intangible assets, net | 13,783 | 13,763 |
| Deferred tax assets, non-current | 5,387 | 5,387 |
| Other assets | 2,761 | 2,848 |
| Total assets | \$ 163,930 | \$ 163,165 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Current liabilities: | | |
| Capital leases – current portion | \$ 617 | \$ 696 |
| Accounts payable | 3,719 | 4,964 |
| Income taxes payable | 401 | 93 |
| Accrued payroll and related items | 22,477 | 22,205 |
| Accrued liabilities | 8,324 | 9,200 |
| Total current liabilities | 35,538 | 37,158 |
| Other non-current liabilities | 4,510 | 4,536 |
| Commitments and contingencies | | |
| Shareholders equity: | | |
| Common shares, \$0.01 per share; authorized 200,000,000 shares; 53,417,300 shares issued and 51,625,975, shares outstanding at April 3, 2011, and 53,359,090 shares issued and 52,488,457 shares outstanding at January 2, 2011 | 534 | 533 |
| Additional paid-in capital | 113,145 | 112,668 |
| Accumulated earnings | 18,187 | 11,166 |
| Accumulated other comprehensive income | 2,323 | 1,980 |
| Treasury shares: 1,791,325 and 870,633 shares at cost at April 3, 2011 and January 2, 2011, respectively | (10,307) | (4,876) |
| Total shareholders equity | 123,882 | 121,471 |

| | | |
|--|------------|------------|
| Total liabilities and shareholders' equity | \$ 163,930 | \$ 163,165 |
|--|------------|------------|

See Notes to Condensed Consolidated Financial Statements.

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APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in thousands, except per share data)
(Unaudited)

| | Thirteen Weeks Ended | |
|--|-----------------------------|--------------------------|
| | April 3, 2011 | April 4, 2010 |
| Net revenue | \$ 88,043 | \$ 85,254 |
| Cost of services | 68,544 | 64,808 |
| Gross profit | 19,499 | 20,446 |
| Operating expenses: | | |
| Selling, general and administrative expenses | 8,301 | 8,146 |
| Legal settlement | 2 | 2,400 |
| Severance and other charges | 425 | 1 |
| Total operating expenses | 8,728 | 10,547 |
| Operating income | 10,771 | 9,899 |
| Other (income) expense, net | 20 | (109) |
| Interest (income) expense, net | 32 | (8) |
| Income before income taxes | 10,719 | 10,016 |
| Income tax expense | 3,698 | 3,456 |
| Net income | \$ 7,021 | \$ 6,560 |
| Net income per share: | | |
| Basic | \$ 0.14 | \$ 0.13 |
| Diluted | \$ 0.13 | \$ 0.12 |
| Weighted average number of shares outstanding: | | |
| Basic | 51,797 | 52,309 |
| Diluted | 53,528 | 54,630 |

See Notes to Condensed Consolidated Financial Statements.

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APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

| | Thirteen Weeks Ended | |
|---|-----------------------------|--------------------------|
| | April 3, 2011 | April 4, 2010 |
| Operating activities: | | |
| Net income | \$ 7,021 | \$ 6,560 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 2,921 | 3,112 |
| Deferred income taxes | 3,445 | 138 |
| Stock compensation expense | 372 | 500 |
| Amortized gain on sale leaseback | (40) | (23) |
| Loss (gain) on sale of property and equipment | 8 | (1) |
| Income taxes payable | 309 | 3,296 |
| Change in operating assets and liabilities | 3,650 | 8,661 |
| Net cash provided by operating activities | 17,686 | 22,243 |
| Investing activities: | | |
| Purchases of property and equipment, net | (2,408) | (2,231) |
| Net proceeds from sale of property and equipment | | 1 |
| Net cash used in investing activities | (2,408) | (2,230) |
| Financing activities: | | |
| Payment of capital lease obligations | (285) | (124) |
| Stock option transactions | 106 | 11 |
| Purchase of treasury stock | (5,431) | |
| Net cash used in financing activities | (5,610) | (113) |
| Effect of exchange rate change on cash | 201 | 209 |
| Net increase in cash and cash equivalents | 9,869 | 20,109 |
| Cash and cash equivalents: | | |
| Beginning balance | 41,399 | 20,557 |
| Ending balance | \$ 51,268 | \$ 40,666 |

See Notes to Condensed Consolidated Financial Statements.

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**APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

(Dollars in thousands, except per share data)

1. Basis of Presentation and Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements of APAC Customer Services, Inc. and its subsidiaries (collectively, the Company) have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of a normal recurring nature) considered necessary for a fair presentation have been included. Interim consolidated financial statements are not necessarily indicative of the financial position or operating results for an entire year.

The Company's international customer care centers use their local currency, the Philippine peso and the Dominican peso, as their functional currency. Assets and liabilities of international customer care centers have been translated at period-end rates, and income and expenses have been translated using average exchange rates for the respective periods. All inter-company transactions and balances have been eliminated. The balance sheet at April 3, 2011 has been derived from the unaudited financial statements at that date and includes all of the information and notes required by GAAP for interim financial statements. These interim financial statements should be read in conjunction with the audited financial statements and notes thereto included in Item 8 of Part II of the Company's Annual Report on Form 10-K for the fiscal year ended January 2, 2011. Copies of the Company's filings are available on a web site maintained by the SEC at <http://www.sec.gov>.

The Company operates on a thirteen week fiscal quarter that ends on the Sunday closest to March 31. The Company operates on a 52/53 week fiscal year that ends on the Sunday closest to December 31.

2. New Accounting Pronouncements

Revenue Recognition

In October 2009, the Financial Accounting Standards Board (FASB) issued guidance on Accounting Standards Codification (ASC) Topic 605 *Revenue Recognition* related to revenue arrangements with multiple deliverables, which revises the criteria for separating, measuring, and allocating arrangement consideration to each deliverable in a multiple element arrangement. The guidance requires companies to allocate revenue using the relative selling price of each deliverable, which must be estimated if the company does not have a history of selling the deliverable on a stand-alone basis or third-party evidence of selling price. This guidance is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. The adoption of this guidance effective January 3, 2011, the beginning of the Company's current fiscal year, did not have any material impact on the Company's unaudited condensed consolidated financial statements.

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APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(Dollars in thousands, except per share data)

3. Accrued Liabilities

The components of other current accrued liabilities included in the unaudited condensed consolidated balance sheets are as follows:

| | April 3, 2011 | January 2, 2011 |
|--|--------------------------|----------------------------|
| Non-qualified retirement plan obligation | \$ 2,260 | \$ 2,375 |
| Accrued capital expenditures | 967 | 1,901 |
| Accrued severance | 732 | 536 |
| Accrued professional fees | 703 | 654 |
| Deferred rent | 582 | 473 |
| Accrued telecom | 432 | 424 |
| Accrued workers compensation | 412 | 431 |
| Other accrued liabilities | 2,236 | 2,406 |
| Total | \$ 8,324 | \$ 9,200 |

4. Accounting for Stock-Based Compensation

The Company has a share-based incentive compensation plan for employees and non-employee directors, which authorizes the granting of various equity-based incentive awards, including stock options and non-vested common shares. The total number of common shares authorized for issuance under the plan is 11.8 million, of which 1.2 million shares are available for future grants at April 3, 2011.

Total stock-based compensation expense was \$0.4 million and \$0.5 million for the thirteen weeks ended April 3, 2011 and April 4, 2010, respectively. As of April 3, 2011, there was \$5.3 million of unrecognized compensation cost related to unvested awards that is expected to be recognized over a weighted-average period of approximately 3.2 years.

A summary of the Company's non-vested common share grant activity during the thirteen weeks ended April 3, 2011 is presented below:

| | Number of Shares |
|----------------------------------|-----------------------------|
| Outstanding on January 2, 2011 | 250,000 |
| Granted | |
| Issued | |
| Cancelled | |
| Outstanding on April 3, 2011 | 250,000 |

The Company did not award non-vested common shares during the thirteen weeks ended April 3, 2011 and April 4, 2010.

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(Unaudited)

(Dollars in thousands, except per share data)

A summary of the Company's stock option grant activity during the thirteen weeks ended April 3, 2011 is presented below:

| | Number of Options | Grant Price Range Per Share | | Weighted Average Exercise Price Per Share | Aggregate Intrinsic Value |
|--------------------------------|----------------------|--------------------------------|---------|---|---------------------------------|
| Outstanding on January 2, 2011 | 5,644,478 | \$ 0.79 | \$ 6.43 | \$ 3.09 | |
| Granted | 119,875 | 5.86 | 6.12 | 5.90 | |
| Exercised | (58,210) | 1.10 | 5.13 | 1.81 | |
| Forfeited | (186,000) | 1.49 | 5.86 | 5.26 | |
| Expired | (4,250) | 2.81 | 5.31 | 3.75 | |
| Outstanding on April 3, 2011 | 5,515,893 | \$ 0.79 | \$ 6.43 | \$ 3.09 | \$ 16,065 |
| Exercisable on April 3, 2011 | 2,745,621 | \$ 0.79 | \$ 6.05 | \$ 2.31 | \$ 10,128 |

Substantially all of the options become exercisable between one to five years after the grant date and generally expire ten years from the grant date.

5. Comprehensive Income

Comprehensive income for the thirteen weeks ended April 3, 2011 and April 4, 2010 is as follows:

| | Thirteen Weeks Ended | |
|---|----------------------|------------------|
| | April 3, 2011 | April 4, 2010 |
| Net income | \$ 7,021 | \$ 6,560 |
| Foreign currency translation adjustment | 262 | 190 |
| Unrealized gain on derivative contracts | 81 | 270 |
| Total comprehensive income | \$ 7,364 | \$ 7,020 |

6. Legal Proceedings

The Company is subject to other lawsuits, claims and governmental investigations arising out of the normal conduct of its business. Management does not believe that the outcome of any pending proceedings will have a material adverse effect on the Company's business, results of operations, liquidity, or financial condition. Although management does not believe that any such proceeding will result in a material adverse effect, no assurance to that effect can be given.

On May 27, 2009, a purported collective/class action complaint captioned *Tiffany Sharpe, et al. v. APAC Customer Services, Inc.* was filed in the United States District Court for the Western District of Wisconsin. On behalf of the named plaintiff, a non-exempt call center employee, and other similarly situated individuals, the complaint asserted violations under the Federal Fair Labor Standards Act (FLSA) related to overtime compensation and wage records. The complaint also asserted violations under Wisconsin Wage Payment and Overtime Compensation Laws based upon the same alleged facts. The complaint purported to allege claims as a nationwide collective action under federal law, as well as a class action under Wisconsin state law. The complaint sought various forms of relief, including

injunctive relief, unpaid overtime wages, liquidated damages, interest, and attorneys' fees and costs. On January 8, 2010, the court entered an order which conditionally certified the case as a collective action under the FLSA.

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(Unaudited)**

(Dollars in thousands, except per share data)

In March 2010, the Company entered into an agreement to resolve the collective action. On June 16, 2010, the Court entered an order approving the resolution of all claims under the FLSA collective action. Under the terms of the agreement, the Company agreed to pay a maximum amount of \$4.0 million to resolve claims by eligible class members, including payments to class members and payments for plaintiff attorneys' fees. As a result, the Company recorded a liability of \$2.4 million for the thirteen weeks ended April 4, 2010 which represented its estimate at the time of the costs to be incurred for attorneys' fees and claims, based on expected opt-in rates for claimants in similar actions. Based on the court's final order approving the agreement, (including setting the amount of plaintiffs' attorneys' fees) and a revised estimated rate of participation from eligible class members, the Company reduced the previously recorded liability by \$0.5 million during the thirteen weeks ended October 3, 2010 to an adjusted recorded liability of \$1.8 million which reflected its revised expectation of the final amount which would ultimately be paid.

On December 21, 2010, a final order of dismissal was entered by the Court triggering the Company's payment obligations under the agreement to resolve the collective action. The final amount paid to class members who participated in the action and to plaintiff's attorney was approximately \$1.8 million.

The Company denied and continues to deny the allegations in the complaint and contends that its policies and practices regarding compensation were proper and in compliance with the law at all times. The Company denies all liability and wrongdoing in this case, but decided to settle this lawsuit in order to avoid the distraction and additional legal expenses that would otherwise be incurred.

7. Debt

As of April 3, 2011, there were no outstanding borrowings under the Revolving Loan Agreement and the Company had cash and cash equivalents of \$51.3 million.

As of January 3, 2011, the Company was party to a Revolving Credit and Security Agreement, as amended, (Revolving Loan Agreement) with PNC Bank National Association (PNC), as agent, and the financial institutions from time to time parties thereto as lenders. The Revolving Loan Agreement provides the Company with a \$40.0 million revolving loan facility which expires in May 2011. On April 27, 2011, the Company entered into the Second Amendment to Revolving Credit and Security Agreement (Second Amendment) which amends the Revolving Credit and Security Agreement (Credit Agreement) among the Company, Agent and Lenders dated May 5, 2008. The Second Amendment extends the term of the Credit Agreement to September 30, 2011. The Company is evaluating various financing alternatives and intends to obtain a replacement facility prior to the expiration of the extended term. The Company anticipates favorable terms for a new facility; however, there can be no assurance that the Company will enter into such an arrangement.

The Company's ability to borrow under the Revolving Loan Agreement depends on the amount of eligible accounts receivable from its clients. The Revolving Loan Agreement contains certain financial covenants including limits on the amount of capital expenditures and maintenance of a minimum fixed charge coverage ratio. Other covenants in the Revolving Loan Agreement prohibit (with limited exceptions) the Company from incurring additional indebtedness, repurchasing outstanding common shares, permitting liens, acquiring, selling or disposing of certain assets, engaging in certain mergers and acquisitions, paying dividends or making certain restricted payments. The Company obtained a waiver from PNC permitting it to repurchase common shares under the program approved by the Company's Board of Directors.

Borrowings under the Revolving Loan Agreement incur a floating interest rate based on the LIBOR index rate or an alternate base rate which approximates the prime rate defined in the Revolving Loan Agreement subjecting the Company to interest rate risk and requires a \$5.0 million interest rate hedge.

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(Unaudited)**

(Dollars in thousands, except per share data)

The Revolving Loan Agreement is secured principally by a grant of a first priority security interest in all of the Company's personal property, including its accounts receivable. In addition, the Company pays a commitment fee on the unused portion of the Revolving Loan Agreement as well as fees on outstanding letters of credit.

The Company was in compliance with its financial covenants as of April 3, 2011. At April 3, 2011, the Company had approximately \$36.9 million in undrawn borrowing capacity under its Revolving Loan Agreement, based upon borrowing base calculations.

8. Severance and Other Charges

The Company recorded \$0.4 million in severance and other charges for the thirteen weeks ended April 3, 2011 related to the elimination of certain management and administrative positions. Cash payments of \$0.1 million for these severance and other charges have been made through April 3, 2011 and remaining cash payments of \$0.3 million are payable through August 2011.

Cash payments of \$0.2 million for severance and other charges related to the September 2010 resignation of Michael Marrow, the Company's former President and Chief Executive Officer and other positions in 2010 have been made through April 3, 2011 and remaining cash payments of \$0.7 million are payable through December 2012.

9. Income Taxes

The Company accounts for income taxes using the asset and liability method. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. A valuation allowance is recorded when management believes it is more likely than not that some portion or all of the deferred tax assets will not be realized in the future. The Company records a reserve for tax contingencies unless it believes it is more likely than not that the deductions giving rise to these contingencies will be sustained if challenged by taxing authorities. Tax contingencies are not material to the financial statements.

Income tax expense for the thirteen weeks ended April 3, 2011 was \$3.7 million. This results in a 34.5% effective income tax rate for the thirteen weeks ended April 3, 2011, which is lower than the statutory rate due to the generation of tax credits. Income tax expense for the thirteen weeks ended April 4, 2010 was \$3.5 million, which results in a 34.5% effective income tax rate for the thirteen weeks ended April 4, 2010.

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APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(Dollars in thousands, except per share data)

10. Earnings Per Share

Basic earnings per share are computed by dividing the Company's net income by the weighted average number of common shares outstanding. Diluted earnings per share are computed by dividing the Company's net income by the weighted average number of shares plus the effect of dilutive potential common shares outstanding and non-vested common shares using the treasury stock method. The following table sets forth the computation of basic and diluted earnings per share for the thirteen weeks ended April 3, 2011 and April 4, 2010:

| | Thirteen Weeks Ended | |
|--|-----------------------------|--------------------------|
| | April 3, 2011 | April 4, 2010 |
| Net income | \$ 7,021 | \$ 6,560 |
| Shares used in basic per share calculation | 51,797 | 52,309 |
| Effects of dilutive securities: | | |
| Stock options | 1,695 | 2,312 |
| Non-vested stock | 36 | 9 |
| Shares used in diluted per share calculation | 53,528 | 54,630 |
| Net income per share: | | |
| Basic | \$ 0.14 | \$ 0.13 |
| Diluted | \$ 0.13 | \$ 0.12 |

For the thirteen weeks ended April 3, 2011, options to purchase 1.8 million shares of common stock were outstanding, but not included in the computation of diluted net income per share because the effect would have been anti-dilutive. For the thirteen weeks ended April 4, 2010, options to purchase 0.9 million shares of common stock were outstanding, but not included in the computation of diluted net income per share because the effect would have been anti-dilutive.

11. Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. The accounting standards establish a fair value hierarchy, which prioritizes the inputs used in measuring fair value into three broad levels as follows:

- Level 1 Quoted prices in active markets for identical assets or liabilities.
- Level 2 Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly.
- Level 3 Unobservable inputs based on the Company's own assumptions.

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APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
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(Unaudited)

(Dollars in thousands, except per share data)

The following table presents the fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of April 3, 2011:

| | Fair Value Measurements as of April 3, 2011 | | |
|---|--|----------------|----------------|
| | Level 1 | Level 2 | Level 3 |
| Assets: | | | |
| Cash equivalents(1) | \$ 51,073 | \$ | \$ |
| Non-qualified retirement plan(2) | 2,260 | | |
| Foreign currency contracts(3) | | 1,234 | |
| Non-current investments(4) | 1,199 | | |
| Liabilities: | | | |
| Non-qualified retirement plan obligation(2) | \$ 2,260 | \$ | \$ |

- (1) Cash equivalents: The carrying amount of these items approximates fair value at period end.
- (2) Non-qualified retirement plan: The Company maintains a non-qualified retirement plan (Select Plan) for highly compensated employees who are limited in the amount of contributions that they can make in the Company s 401K plan. As of April 3, 2011, the fair value of investments in the Select Plan totaled \$2.3 million and is reflected on the Company s balance sheet in other current assets. The offsetting obligation to employees participating in the Select Plan, which will always equal the fair value of the investments, are recorded on the Company s balance sheet in other current liabilities.
- (3) Foreign currency contracts: The carrying amount of these items is based on the market valuation approach which is provided by the counter-party institutions and uses the closing or mid-market rate and forward points obtained from external sources on the date of valuation. There are no guaranteed selling prices for these forward currency contracts.
- (4) Non-current investments: The carrying amount of these items, which represent Philippine treasury bills, approximates fair value as of April 3, 2011 and is recorded as a component of other assets on the Company s balance sheet.

The carrying amounts of accounts receivable, accounts payable and short-term debt approximate fair value.

There were no transfers of assets or liabilities between Level 1 and Level 2 during the thirteen weeks ended April 3, 2011.

12. Derivative Instruments

The Company uses forward contracts to mitigate foreign currency risk. The derivatives are designated as cash flow hedges to the extent that the instruments qualify for accounting as a hedging instrument; therefore, the effective portion of gains and losses that result from changes in fair value of the derivative instruments are recorded in accumulated other comprehensive income (OCI) until the hedged transaction affects income, at which time gains and/or losses are realized. The Company expects these amounts to be reclassified into earnings over the next eighteen months. If the instrument does not qualify for accounting as a hedge, the change in the value of the instrument during the reporting period is recorded immediately to earnings. The Company assesses hedge effectiveness each reporting period.

The objective of the foreign currency hedge contract is to mitigate the variability in cash flows and expenses over the period of the hedge contracts due to the foreign currency risk associated with the repayment of the intercompany accounts payable from the U.S. operations to the Philippines representing the Philippine s share of revenue. The

Company currently engages in forward contracts with three major financial credit institutions. Forward contracts to purchase 1,613 million Philippine pesos at a U.S. dollar notional of \$36.0 million were outstanding as of April 3, 2011.

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APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(Dollars in thousands, except per share data)

Each contract is designated to a hedged item which is settled periodically. The hedged item represents the change in the U.S. dollar cash flow necessary to settle the accounts payable balance at periodic intervals over the next 18 months. The settlement timing corresponds with the payroll and rent cycles in the Philippines. No ineffectiveness is anticipated because the notional amount of the contracts is no more than 95% of the anticipated payable balance and declines steadily over the course of the next eighteen months. Also, the maturity date of the forward contract coincides with the timing of the effective repayment of the intercompany payable. The Company had no gain or loss recognized in income related to the ineffectiveness for the thirteen weeks ended April 3, 2011 and April 4, 2010.

At April 3, 2011 and January 2, 2011, the fair value carrying amount of the Company's derivative instruments was recorded as follows:

| | Asset Derivatives | | |
|---|-----------------------------------|--------------------------|----------------------------|
| | Balance Sheet Location | Fair Value | |
| | | April 3, 2011 | January 2, 2011 |
| Derivatives designated as hedging instruments : | | | |
| Foreign currency contracts | Other Current Assets | \$ 1,234 | \$ 1,109 |
| Total derivatives | | \$ 1,234 | \$ 1,109 |

| | Liability Derivatives | | |
|---|-----------------------------------|--------------------------|----------------------------|
| | Balance Sheet Location | Fair Value | |
| | | April 3, 2011 | January 2, 2011 |
| Derivatives designated as hedging instruments : | | | |
| Foreign currency contracts | Accrued Liabilities | \$ | \$ 22 |
| Total derivatives | | \$ | \$ 22 |

The effect of derivative instruments on the unaudited condensed consolidated statement of operations for the thirteen weeks ended April 3, 2011 and April 4, 2010 was as follows:

| Derivatives Designated as Cash Flow Hedging Instruments | Amount of Gain (Loss) Recognized in OCI on Derivatives (Effective Portion) | | Thirteen Weeks Ended | Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) | |
|--|---|--------------------------|-----------------------------|--|--------------------------|
| | April 3, 2011 | April 4, 2010 | | Location | |
| | April 3, 2011 | April 4, 2010 | | April 3, 2011 | April 4, 2010 |
| Foreign currency contracts | \$ 81 | \$ 270 | Cost of Services | \$ 249 | \$ 251 |

As of April 3, 2011, \$1.1 million of unrealized gains included in accumulated OCI relate to contracts that may impact earnings during the next 12 months.

13. Subsequent Events

On May 1, 2011, the Company acquired a portion of the tele-sales services business unit of SEI, LLC. The acquisition includes the contracts and related services which SEI has historically delivered to one of the world's leading

technology companies.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Our management's discussion and analysis of financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and related notes thereto appearing elsewhere in this report and our audited consolidated financial statements which appear in Item 8 of Part II of our Annual Report on Form 10-K for the fiscal year ended January 2, 2011. Our management's discussion and analysis contains forward-looking statements. All forward-looking statements are inherently uncertain as they are based on various expectations and assumptions about future events and are subject to known and unknown risks and uncertainties, and other factors that may cause our actual results, performance, or achievements to be materially different from those expressed or implied by the forward-looking statements. See *Forward Looking Statements and Factors That May Affect Future Results* on page 3 and page 4 of this Quarterly Report on Form 10-Q and Item 1A in Part II of this Quarterly Report on Form 10-Q.

Overview

We are a leading provider of customer care services and solutions to market leaders in the healthcare, communications, business services, media & publishing, travel & entertainment, technology and financial services industries. Our services are provided through customer care centers staffed with skilled customer service representatives in domestic, international, and client-owned locations. As of April 3, 2011, we operated 15 customer care centers; eight domestic, two domestic client-owned facilities, four international centers located in the Philippines and one international facility located in the Dominican Republic. The lease for our center in Montevideo, Uruguay was signed in 2010 and we expect to begin operations in the second quarter of 2011. The lease for our newest center in the Philippines was signed in April 2011 and we expect to begin operations late in the second quarter of 2011. As of April 3, 2011, our domestic operations consisted of approximately 6,300 workstations and our international operations consisted of approximately 4,700 workstations.

During 2008, we restructured our operations resulting in the reduction of overhead costs and headcount, refinanced our debt, and took steps to improve our operating efficiencies. We realized an immediate impact from these and other cost savings initiatives resulting in us being profitable on a full year basis for fiscal year 2008. In 2009, we expanded the sales organization and focused on expanding our service offerings and client base. In 2010, we continued to expand our service offerings in off-shore locations and increased our capital spending positioning us for future growth.

In September 2010, Kevin Keleghan joined the Company as President and Chief Executive Officer after serving on our Board of Directors during the previous year. Mr. Keleghan brings broad-based experience and strong strategic capabilities to lead us into the future. He has more than 25 years of experience in financial and business services, call center management, and outsourcing, along with a strong track record of operational leadership and of strategically building businesses.

In the first quarter of 2011, our revenue increased 3.3% to \$88.0 million as compared to \$85.3 million for the first fiscal quarter of 2010. Our gross profit totaled \$19.5 million, generating a margin of 22.1%. Net income rose to \$7.0 million, a 7.0% increase as compared to \$6.6 million in the prior year fiscal quarter.

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Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States requires us to make estimates and judgments that affect the amounts reported in the unaudited condensed consolidated financial statements and accompanying notes. Certain of our accounting policies are considered critical, due to the level of subjectivity and judgment necessary in applying these policies and because the impact of these estimates and assumptions on our financial condition and operating performance may be material. On an ongoing basis, we evaluate our estimates and judgments in these areas based on historic experience and other relevant factors. The estimates as of the date of the financial statements reflect our best judgment giving consideration to all currently available facts and circumstances. We believe our estimates and judgments are reasonable, however, actual results and the timing of the recognition of such amounts could differ from those estimates.

We have used methodologies that are consistent from year to year in all material respects. We have identified the following accounting policies and estimates that we believe are most critical in the preparation of our unaudited condensed consolidated financial statements: accounting for derivatives, allowance for doubtful accounts, accounting for employee benefits, revenue recognition, accounting for stock-based compensation and income taxes. For details concerning these critical accounting policies and estimates see Item 7 of Part II of our Annual Report on Form 10-K for the fiscal year ended January 2, 2011, under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies and Estimates" and Note 3 to our audited consolidated financial statements which appears in Item 8 of Part II of our Annual Report on Form 10-K for the fiscal year ended January 2, 2011. Any deviation from these policies or estimates could have a material impact on our unaudited condensed consolidated financial statements.

Table of Contents**Results of Operations**

The following table sets forth selected information about our results of operations for the thirteen weeks ended April 3, 2011 and April 4, 2010, respectively. Certain additional components of cost of services have been included as we believe they would enhance an understanding of our results of operations. All amounts in the table below are presented in thousands.

| | Thirteen Weeks Ended | | Fav (Unfav) % Change |
|--|-----------------------------|--------------------------|-------------------------------------|
| | April 3, 2011 | April 4, 2010 | |
| Net Revenue | \$ 88,043 | \$ 85,254 | 3.3% |
| Cost of Services: | | | |
| Direct labor | 46,171 | 45,202 | (2.1) |
| Other facility expenses | 22,373 | 19,606 | (14.1) |
| Total cost of services | 68,544 | 64,808 | (5.8) |
| Percentage of revenue | 77.9% | 76.0% | |
| Gross profit | 19,499 | 20,446 | (4.6) |
| Gross profit margin | 22.1% | 24.0% | |
| Operating Expenses: | | | |
| Selling, general and administrative expenses | 8,301 | 8,146 | (1.9) |
| Legal settlement | 2 | 2,400 | * |
| Severance and other charges | 425 | 1 | * |
| Total operating expenses | 8,728 | 10,547 | 17.2 |
| Operating income | 10,771 | 9,899 | 8.8 |
| Other (income) expense, net | 20 | (109) | * |
| Interest (income) expense, net | 32 | (8) | * |
| Income before income taxes | 10,719 | 10,016 | 7.0 |
| Income tax expense | 3,698 | 3,456 | (7.0) |
| Net income | \$ 7,021 | \$ 6,560 | 7.0% |

* Means that the percentage change is not meaningful

Non-GAAP Financial Measures

To supplement our unaudited condensed consolidated financial statements presented in accordance with GAAP, we present EBITDA and adjusted EBITDA, which are defined as non-GAAP financial measures. The presentation of these non-GAAP financial measures is not intended to be considered in isolation or as a substitute for the financial information presented in accordance with GAAP. The items excluded from these non-GAAP financial measures are significant components of our financial statements and must be considered in performing a comprehensive analysis of

our overall financial results.

We believe these non-GAAP financial measures provide meaningful supplemental information and are useful in understanding our results of operations and analyzing trends because they excludes certain charges that are not part of our ordinary business operations.

EBITDA and adjusted EBITDA are measures used by our lenders, investors and analysts to evaluate our financial performance and our ability to pay interest and repay debt. These measures are also indicative of our ability to fund the capital investments necessary for our continued growth. We use these measures, together with our GAAP financial metrics, to assess our financial performance, allocate resources, measure our performance against debt covenants and evaluate our overall progress towards meeting our long-term financial objectives.

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We believe that these non-GAAP financial measures are useful to investors and analysts in allowing for greater transparency with respect to the supplemental information used by us in our financial and operational decision making. In addition, we believe investors, analysts and lenders benefit from referring to EBITDA and adjusted EBITDA when assessing our performance and expectations of our future performance. However, this information should not be used as a substitute for our GAAP financial information; rather it should be used in conjunction with financial statement information contained in our unaudited condensed consolidated financial statements presented in accordance with GAAP.

Our calculation of EBITDA and adjusted EBITDA may not be consistent with calculations of similar measures used by other companies. The accompanying notes have more details on the GAAP financial measure that is most directly comparable to our non-GAAP financial measure and the related reconciliation between these financial measures.

| | Thirteen Weeks Ended (1) | | |
|--|---|--------------------------|-------------------------------------|
| | April 3, 2011 | April 4, 2010 | Fav (Unfav) % Change |
| | (Dollars in thousands except statistical data and notes) | | |
| EBITDA (2) | \$ 13,672 | \$ 13,120 | 4.2% |
| Adjusted EBITDA (2) | \$ 14,099 | \$ 15,521 | (9.2)% |
| Statistical information: | | | |
| Number of customer care centers: | | | |
| Domestic | 10 | 10 | |
| International | 5 | 5 | |
| Total | 15 | 15 | |
| Number of workstations, end of period: | | | |
| Domestic | 6,296 | 6,260 | |
| International | 4,680 | 4,201 | |
| Total | 10,976 | 10,461 | |

Notes to Non-GAAP Financial Measures

(1) We operate on a thirteen-week fiscal quarter that ends on the Sunday closest to March 31.

(2) We define EBITDA as net income plus income tax expense, depreciation and amortization, and interest expense.

We define adjusted EBITDA as EBITDA adjusted for legal settlement expense and severance and other charges. EBITDA and adjusted EBITDA are measures used by our lenders, investors and analysts to evaluate our financial performance and our ability to pay interest and repay debt. These measures are also indicative of our ability to fund the capital investments necessary for our continued growth. We use these measures, together with our GAAP financial metrics, to assess our financial performance, allocate resources, measure our performance against debt covenants and evaluate our overall progress towards meeting our long-term financial objectives.

EBITDA and adjusted EBITDA are not intended to be considered in isolation or used as a substitute for net income or cash flow from operations data presented in accordance with GAAP or as a measure of liquidity. The items excluded from EBITDA and adjusted EBITDA are significant components of our statements of operations and must be considered in performing a comprehensive assessment of our overall financial results.

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EBITDA and adjusted EBITDA can be reconciled to net income, which we believe to be the most directly comparable financial measure calculated and presented in accordance with GAAP, as follows:

| | Thirteen Weeks Ended | |
|--------------------------------|-------------------------------|--------------------------|
| | April 3, 2011 | April 4, 2010 |
| | (Dollars in thousands) | |
| Net income | \$ 7,021 | \$ 6,560 |
| Interest (income) expense, net | 32 | (8) |
| Income tax expense | 3,698 | 3,456 |
| Depreciation and amortization | 2,921 | 3,112 |
| EBITDA | \$ 13,672 | \$ 13,120 |
| Legal Settlement | 2 | 2,400 |
| Severance and other charges | 425 | 1 |
| Adjusted EBITDA | \$ 14,099 | \$ 15,521 |

Table of Contents***Comparison of Results of Operations for the Thirteen Weeks Ended April 3, 2011 and April 4, 2010***

Net revenue increased 3.3% to \$88.0 million for the thirteen weeks ended April 3, 2011, as compared to \$85.3 million for the thirteen weeks ended April 4, 2010. The increase in revenue of \$2.7 million is primarily driven by growth from new and existing clients of \$7.3 million in the media & publishing vertical, \$2.0 million in the technology vertical, \$1.7 in the business services vertical and \$0.9 million of other services, partially offset by a \$7.1 million decrease in the communications vertical and a \$2.1 million decrease in the healthcare vertical associated with a client who exited this vertical in the fourth quarter of 2010.

Cost of services increased \$3.7 million, or 5.8%, to \$68.5 million for the thirteen weeks ended April 3, 2011, from \$64.8 million for the thirteen weeks ended April 4, 2010. Direct labor increased \$1.0 million, or 2.1%, primarily driven by increased volume in the off-shore media & publishing vertical, increased volume in the domestic technology and business services verticals, and decreased domestic efficiencies. Total facility and other costs increased \$2.7 million, or 14.1%, primarily due to \$1.3 million of increased facility costs associated with increased growth at our customer care center in the Dominican Republic, expansion at our Leyte, Philippines facility and the build-out of our customer care center in Montevideo, Uruguay. Other facility expenses increased \$1.4 million due to \$0.4 million of increased technology costs, \$0.3 million of salaries and wages associated with increased operations support and \$0.7 million of other facility expenses. Cost of services as a percentage of revenue increased to 77.9% for the thirteen weeks ended April 3, 2011, as compared to 76.0% for the thirteen weeks ended April 4, 2010, primarily due to increased facility and other costs and decreased domestic efficiencies.

Gross profit decreased \$0.9 million, or 4.6%, to \$19.5 million for the thirteen weeks ended April 3, 2011, as compared to \$20.4 million for the thirteen weeks ended April 4, 2010. Increased volume in the off-shore media & publishing vertical and increased volume in the domestic technology and business services verticals was more than offset by increased facility and other costs related to growth and expansion in our off-shore facilities and decreased domestic efficiencies. Gross profit margin decreased from 24.0% for the thirteen weeks ended April 4, 2010, as compared to 22.1% for the thirteen weeks ended April 3, 2011, driven by increased facility and other costs.

Selling, general and administrative expenses were \$8.3 million for the thirteen weeks ended April 3, 2011, a \$0.2 million increase from \$8.1 million for the thirteen weeks ended April 4, 2010. The increase is primarily associated with a \$0.2 million increase in compensation and benefits, a \$0.2 million increase in travel and entertainment expense, a \$0.2 million increase in technology expense and a \$0.2 million increase in other operating expenses, partially offset by a \$0.6 million decrease in costs associated with the final amortization of intangible assets in 2010.

Legal settlement expense was \$2.4 million for the thirteen weeks ended April 4, 2010 related to a proposed litigation settlement of the *Tiffany Sharpe, et al. v. APAC Customer Services, Inc.* suit. The \$2.4 million recorded for the thirteen weeks ended April 4, 2010 represented our estimate at that time of the costs to be incurred for attorneys' fees and claims, based on expected opt-in rates for claimants in similar actions. For more information regarding the 2010 legal settlement, see Note 6 of the Notes to Condensed Consolidated Financial Statements in Item 1 of this Quarterly Report on Form 10-Q.

Severance and other charges were \$0.4 million for the thirteen weeks ended April 3, 2011 and relate to the elimination of certain management and administrative positions.

Operating income was \$10.8 million for the thirteen weeks ended April 3, 2011, as compared to \$9.9 million for the thirteen weeks ended April 4, 2010. The \$0.9 million increase was the result of a \$2.4 million decrease in legal settlement expense, partially offset by decreased gross profit, as noted above and increased severance and other charges.

Net interest expense of less than \$0.1 million for the thirteen weeks ended April 3, 2011 was primarily related to \$0.1 million from the amortization of points on forward contracts, partially offset by \$0.1 million of fees associated with the Revolving Loan Facility with PNC. Net interest income of less than \$0.1 million for the thirteen weeks ended April 4, 2010 was primarily related to \$0.1 million from the amortization of points on forward contracts, partially offset by \$0.1 million of fees associated with the Revolving Loan Facility with PNC.

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EBITDA was \$13.7 million for the thirteen weeks ended April 3, 2011, a \$0.6 million increase from \$13.1 million for the thirteen weeks ended April 4, 2010. Adjusting for legal settlement and severance and other charges, adjusted EBITDA decreased \$1.4 million to \$14.1 million for the thirteen weeks ended April 3, 2011, as compared to \$15.5 million for the thirteen weeks ended April 4, 2010, primarily due to the decrease in gross profit, as noted above. More information concerning these non-GAAP financial measures, including the definition of EBITDA and adjusted EBITDA and a reconciliation of these measures to the most directly comparable financial measures calculated and presented in accordance with GAAP, can be found under the heading *Non-GAAP Financial Measures* and the accompanying notes thereto appearing elsewhere in this Management's Discussion and Analysis of Financial Condition and Results of Operations.

Income tax expense for the thirteen weeks ended April 3, 2011 was \$3.7 million. This results in a 34.5% effective income tax rate for the thirteen weeks ended April 3, 2011, which is lower than the statutory rate due to the generation of tax credits. Due to the utilization of net operating loss carryforwards and tax credits, our estimated cash taxes paid for fiscal year 2011 will be approximately 10-15% of income before taxes. Income tax expense for the thirteen weeks ended April 4, 2010 was \$3.5 million which represents an effective rate of 34.5%.

Net income for the thirteen weeks ended April 3, 2011 was \$7.0 million, as compared to \$6.6 million for the thirteen weeks ended April 4, 2010. The \$0.4 million increase was primarily due to the \$2.4 million decrease in legal settlement expense, partially offset by decreased gross profit, increased severance and other charges and increased income tax expense.

Liquidity and Capital Resources

The following table sets forth our unaudited condensed consolidated statements of cash flow data for the thirteen weeks ended April 3, 2011 and April 4, 2010, respectively.

| | Thirteen Weeks Ended | |
|---|-------------------------------|-----------------|
| | April 3, | April 4, |
| | 2011 | 2010 |
| | (Dollars in thousands) | |
| Net cash provided by operating activities | \$ 17,686 | \$ 22,243 |
| Net cash used in investing activities | (2,408) | (2,230) |
| Net cash used in financing activities | (5,610) | (113) |
| Effect of exchange rate changes on cash | 201 | 209 |
| Net increase in cash and cash equivalents | \$ 9,869 | \$ 20,109 |

Operating Activities

Net cash provided by operating activities was \$17.7 million for the thirteen weeks ended April 3, 2011, as compared to \$22.2 million for the thirteen weeks ended April 4, 2010. The \$4.5 million decrease in cash is primarily related to a \$3.8 million change in accounts receivable due to the timing of cash receipts and a \$2.4 million accrual in 2010 for legal settlement expense, partially offset by a \$1.6 million decrease in accrued payroll primarily related to incentive compensation and net changes in prepaid expenses and other assets and liabilities of \$0.1 million.

Investing Activities

Net cash used in investing for the thirteen weeks ended April 3, 2011 consisted primarily of \$1.4 million in continued investment in site operational and information technology equipment and \$1.0 million in capital expenditures related to client implementations. Cash used in investing activities for the thirteen weeks ended April 4, 2010 consisted primarily of \$1.5 million in continued investment in operational and information technology equipment and \$0.7 million in capital expenditures related to client implementations.

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Financing Activities

Net cash used in financing activities of \$5.6 million for the thirteen weeks ended April 3, 2011 is primarily the result of a \$5.4 million repurchase of our common stock and \$0.3 million of payments against capital lease obligations, partially offset by \$0.1 million of cash received from the exercise of stock options. Net cash used in financing activities of \$0.1 million for the thirteen weeks ended April 4, 2010 relates to payments made on capital leases, slightly offset by cash received from the exercise of stock options.

Bank Financing

As of April 3, 2011, there were no outstanding borrowings under the Revolving Loan Agreement and we had cash and cash equivalents of \$51.3 million.

During the thirteen weeks ended April 3, 2011, we were party to a Revolving Credit and Security Agreement, as amended, (Revolving Loan Agreement) with PNC Bank National Association (PNC), as agent, and the financial institutions from time to time parties thereto as lenders. The Revolving Loan Agreement provides us with up to a \$40.0 million revolving loan facility which expires in May 2011. On April 27, 2011, we entered into the Second Amendment to Revolving Credit and Security Agreement (Second Amendment) which amends the Revolving Credit and Security Agreement (Credit Agreement) among the Company, Agent and Lenders dated May 5, 2008. The Second Amendment extends the term of the Credit Agreement to September 30, 2011. We are evaluating various financing alternatives and intend to obtain a replacement facility prior to the expiration of the extended term. We anticipate favorable terms for a new facility; however, there can be no assurance that we will enter into such an arrangement. The Revolving Loan Agreement contains certain financial covenants including limits on the amount of capital expenditures and maintenance of a minimum fixed charge coverage ratio. Other covenants in the Revolving Loan Agreement prohibit us (with limited exceptions) from incurring additional indebtedness, repurchasing outstanding common shares, permitting liens, acquiring, selling or disposing of certain assets, engaging in certain mergers and acquisitions, paying dividends or making certain restricted payments. We obtained a waiver from our current lender permitting us to execute our stock repurchase program as approved by our Board of Directors. Our ability to borrow under the Revolving Loan Agreement depends on the amount of eligible accounts receivable from our clients.

We had approximately \$36.9 million of undrawn borrowing capacity under the Revolving Loan Agreement as of April 3, 2011, based upon borrowing base calculations. We were in compliance with our financial covenants as of April 3, 2011.

Future Liquidity

We expect that our cash balances of \$51.3 million, cash flows from operations and available borrowings of \$36.9 million under our Revolving Loan Agreement will be sufficient to meet projected operating needs, fund any planned capital expenditures and repay debt obligations for the next twelve months.

We are not aware of any issues with our lenders which might cause funds not to be available for us to draw upon under the terms of our Revolving Loan Agreement.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to the impact of U.S. interest rate changes directly related to our normal operating and funding activities and foreign currency exchange risk related to our operating costs in international locations. Our Revolving Loan Agreement bears interest at floating rates, subjecting us to interest rate risk. To date, the impact from interest rate fluctuations has not been material.

The impact from foreign currency exchange rates has become significant due to the change in the U.S. dollar relative to the Philippine peso and the increase in cost of services due to our expanded operations in international locations. We maintain a currency rate hedging program with the objective of mitigating the impact of significant fluctuations in the U.S. dollar / Philippine peso exchange rate. The objective of the hedge transaction is to mitigate the variability in cash flows and expenses over the period of the hedge contracts due to the foreign currency risk associated with the repayment of the intercompany accounts payable from the U.S. operations to the Philippines representing the Philippines share of revenue. Forward contracts to purchase 1,613 million Philippine pesos at a U.S. dollar notional of \$36.0 million were outstanding as of April 3, 2011.

As we continue to expand operations in the Dominican Republic and Uruguay, the impact from foreign currency exchange rates will become more significant. We will evaluate the use of derivatives to mitigate this exposure as deemed necessary.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

As of April 3, 2011, under the direction of our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of our disclosure controls and procedures. The term disclosure controls and procedures, as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934, as amended, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Securities Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation, of our disclosure controls and procedures as of April 3, 2011, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the thirteen weeks ended April 3, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents**Part II. Other Information****Item 1A. Risk Factors**

For a detailed discussion of the risks and uncertainties associated with our business see Item 1A of Part I of our Annual Report on Form 10-K for the fiscal year ended January 2, 2011. There have been no material changes to these risk factors since that report.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table provides information about our purchase of our common stock during the first fiscal quarter of 2011:

Issuer Purchases of Equity Securities

| Period | Total Number of Shares (or Units) Purchased | Average Price Paid per Share (or Unit) | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1) | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (1) |
|-----------------------|--|---|---|---|
| Beg Balance 1/02/2011 | 870,633 | \$ 5.60 | 870,633 | 4,129,367 |
| 1/03/2011 1/30/2011 | 261,438 | 5.96 | 261,438 | 3,867,929 |
| 1/31/2011 2/27/2011 | 331,657 | 5.79 | 331,657 | 3,536,272 |
| 2/28/2011 4/03/2011 | 327,597 | 5.96 | 327,597 | 3,208,675 |
| Total | 1,791,325 | \$ 5.75 | 1,791,325 | 3,208,675 |

- (1) On August 18, 2010, we announced that our Board of Directors had authorized the repurchase of up to an aggregate of five million shares of our common stock. Under the stock repurchase program, purchases will be made from time to time on the open market at prevailing market prices or in negotiated transactions off the market. The repurchase program is expected to continue over the next 12 months unless extended or shortened by the Board of Directors. We are not obligated to acquire any particular amount of common stock as a result of the plan, which may be suspended at any time at our discretion.

Item 6. Exhibits

The exhibits required by Item 601 of Regulation S-K are listed in the Exhibit Index attached hereto.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

APAC Customer Services, Inc.

Date: May 12, 2011

By: /s/ Kevin T. Keleghan
Kevin T. Keleghan
President and
Chief Executive Officer
(Principal Executive Officer)

Date: May 12, 2011

By: /s/ Andrew B. Szafran
Andrew B. Szafran
Senior Vice President and
Chief Financial Officer
(Principal Financial Officer)

Date: May 12, 2011

By: /s/ Joseph R. Doolan
Joseph R. Doolan
Vice President and Controller
(Principal Accounting Officer)

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Exhibit Index

| Exhibit Number | Description |
|-----------------------|---|
| 3.1 | Amended and Restated Articles of Incorporation of APAC Customer Services, Inc., incorporated by reference to APAC Customer Services, Inc. s Annual Report on Form 10-K for the fiscal year ended January 1, 2006. |
| 3.2 | Second Amended and Restated Bylaws of APAC Customer Services, Inc., dated August 20, 2007, incorporated by reference to APAC Customer Services, Inc. s Current Report on Form 8-K, dated August 22, 2007. |
| 4.1 | Specimen Common Stock Certificate, incorporated by reference to APAC Customer Services, Inc. s Annual Report on Form 10-K for the fiscal year ended December 28, 2008. |
| 10.1 | Second Amendment to Revolving Credit and Security Agreement, dated April 27, 2011, incorporated by reference to APAC Customer Services, Inc. s Current Report on Form 8-K, filed on May 3, 2011. |
| 31.1 | Certification of Chief Executive Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |